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Kazakhstan's Bankruptcy Law Overhaul

Key changes proposed in the new Rehabilitation and Bankruptcy Law affect involuntary petitions for bankruptcy, invalidations, trustees' avoidance powers, debtors' dissolution, and priority of claims.

On 29 December 2012, the Kazakhstan Ministry of Finance proposed key changes to the current bankruptcy law through the new Rehabilitation and Bankruptcy Law (Draft Law). The Draft Law and the current law apply to legal entities and registered entrepreneurs (individuals). The Draft Law is currently in review with the Mazhilis, the lower chamber of the Parliament of Kazakhstan, and is expected to become effective in 2013. The Draft Law emphasizes the need for an effective bankruptcy system that encourages the rational use and distribution of assets upon the liquidation of insolvent debtors and promotes the recovery of debtors in economic difficulties so as to permit the continuation of their economic activities.

Involuntary Petitions for Bankruptcy

The current bankruptcy law permits the following categories of creditors to force an insolvent debtor into bankruptcy proceedings:

- The Kazakhstan tax committee for claims exceeding US\$1,154
- Other creditors for claims exceeding US\$3,462 (for individual entrepreneurs) or US\$11,540 (for legal entities)

Under the Draft Law, creditors with claims related to personal injury, alimony, payroll, and compensation may also force an insolvent debtor into bankruptcy proceedings. A debtor is insolvent if it is unable to pay its debt within three months from the time it is due.

Invalidations and Trustees' Avoidance Powers

The normal statute of limitations for the invalidation of a transaction is three years prior to the initiation of bankruptcy or rehabilitation proceedings. Under the Draft Law, the statute of limitations period will be frozen from the date the bankruptcy or rehabilitation case is initiated until the bankruptcy or rehabilitation trustee discovers the avoidable transaction. The period for initiating an action to invalidate an avoidable transaction discovered by the bankruptcy or rehabilitation trustee is set by the creditor committee.

Creditors or bankruptcy trustees may seek to invalidate a transaction on any of the following additional grounds proposed by the Draft Law:

- The transaction led to a financial loss.
- The transaction did not match the debtor's usual activity or was not permitted by law or the debtor's charter.
- The debtor's property was transferred free of charge, at below market prices or without economic substance, to the detriment of creditors (including for temporary use).

When it is impossible to clawback assets following the invalidation of a transaction, the transferee must compensate the estate for the value of the assets.

Under the current bankruptcy law, the rehabilitation trustee may refuse to perform a debtor's obligations, in whole or in part, if the trustee believes performance will be to the detriment of other creditors or if the agreement contains burdensome provisions for the debtor in comparison with analogous agreements. The Draft Law also empowers the rehabilitation trustee to refuse to perform a debtor's obligations, in whole or in part, with affiliated parties.

Debtors' Dissolution Outside of Bankruptcy Procedure

Creditors may petition the courts to declare that a debtor is bankrupt and dissolve the debtor without going through bankruptcy proceeding if the debtor and its assets cannot be found for bankruptcy proceedings.

Priority of Claims

The Draft Law provides for a new order of priority for creditor claims. As a result, the first and second priorities were combined into the first priority. All other claims have moved up one priority. The proposed priority of claims is as follows:

1. First priority claims must be paid in the following order: personal injury damages, unpaid alimony, employee payroll and compensation, social contributions to the National Social Insurance Fund and mandatory pension contributions, and compensation due under copyright agreements.
2. Second priority claims must be paid to secured creditor claims.
3. Third priority claims must be paid to tax claims.
4. Fourth priority claims must be paid to unsecured creditor claims, payroll and compensation for persons whose wages increased during the year prior to initiation of bankruptcy proceedings, and claims of secured creditors for the difference between the amount received from a pledged property and the amount actually owed.
5. Fifth priority claims must be paid to contract damage claims as well as fines and penalties on such claims.

It should be noted that administrative expenses and taxes incurred during the period of bankruptcy proceedings are outside of the order of priority for creditor claims and must be paid ahead of all creditor claims.

Notable New Terminology

The Draft Law introduces a number of terms, including the following.

- **Affiliated party.** An individual or legal entity (except for state bodies and national managing holdings) that has the ability to, directly or indirectly, direct or influence decisions made by a participant of the rehabilitation and bankruptcy proceedings, including through contract. The introduction of the term "affiliated party" into the bankruptcy law will empower a bankruptcy trustee to challenge and invalidate agreements improperly concluded with affiliated parties prior to initiation of bankruptcy or rehabilitation proceedings. Affiliated parties of a debtor or creditor may not serve as a bankruptcy trustee.
- **Temporary administrator.** A person appointed by the court during the preparation of a rehabilitation plan to prepare a creditor register and to reconcile transactions that do not conform to the ordinary commercial operations of the debtor.
- **Rehabilitation trustee.** A person appointed to manage the property and affairs of an insolvent debtor during the rehabilitation process.
- **Bankruptcy trustee.** A person appointed by the Financial Monitoring Committee of the Ministry of Finance of the Republic of Kazakhstan to oversee the liquidation of the debtor during the bankruptcy process.

Changes to Other Legal Acts

The following changes to other legal acts in connection with the Draft Law have been proposed:

- **Code of Administrative Violations.** Amendments to the code include sanctions for improper performance of duties by the trustee and failure by the trustee to securely monitor property of the estate. The debtor's management or owners may be fined for concealment or destruction of assets, transfer of assets, concealment of information about assets, or falsification of accounting documents.
- **Law on State Registration of Legal Entities' Branches and Representative Offices.** Persons who, for three previous years, were listed as shareholders (participants) or served as general managers of legal entities that were liquidated due to bankruptcy will be prohibited from establishing a new legal entity for a period of one year after the bankruptcy has been declared by the court.

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